

# Investment Grade Acquisition Financing Commitments

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The investment grade bridge loan commitment is an important component of middle and large cap merger and acquisition transactions involving investment grade acquirors<sup>1</sup> (also referred to in this article as borrowers). The bridge loan commitment provides assurance to the acquiror and seller that the acquiror will be able to fund the cash portion of the purchase price at closing, whether or not the acquiror has suffered a material adverse change and whether or not the funds can be raised in the capital markets. Examples of transactions announced in 2017 with an investment grade bridge loan commitment include: CVS / Aetna (\$49.0 billion); Gilead / Kita Pharma (\$9.0 billion); Amazon / Whole Foods (\$13.7 billion); and Thermo Fisher / Patheon (\$7.3 billion). This article provides an overview of bridge loan commitments for investment grade companies in the U.S. bank market.

Investment grade bridge commitments are often provided in the U.S. by large banks, and provide a commitment to lend a short-term bank loan (typically, the maturity is 364 days) to fund the cash purchase price of an acquisition in the event long-term or “permanent” (i.e., more than one-year maturity) financing is not available. While the bulk of the permanent debt financing will have a maturity of more than one year, there are exceptions. This permanent financing is generally in the form of a combination of notes issued in the capital markets and bank term loans, with notes providing the majority of the financing. The banks offering the commitments must have sufficient capital available to hold these commitments through the sometimes lengthy executory periods of merger and acquisition transactions (although, as is discussed below, the commitments are syndicated after signing). To the extent a financing package includes a mix of bridge loans and bank term loans, the bank term loan component adds flexibility to the borrower’s capital structure since bank debt has more liberal prepayment provisions than notes issued in the capital markets (*in lieu* of or to refinance bridge loans). The balance of the funds required might be obtained from cash on the balance sheet of the borrower, commercial paper and sometimes, the target company’s cash on hand.

The terms of the bridge loan typically include a 364-day maturity, no prepayment penalty/call protection, and floating interest rates. Unlike in a below investment grade leveraged buyout bridge commitment, there is no provision to convert the bridge into longer term debt after a year at the option of the lenders. Expenses including ticking fees, funding fees, duration fees and increasing interest rate terms make the bridge loan more expensive financing than is expected for the permanent financing. Instead of incurring the bridge loans, the borrower expects to fund the acquisition with the proceeds of permanent debt and sometimes, equity financing. Only if the borrower is unable to raise permanent financing to fund the acquisition (or is unable to do so on attractive terms) will it draw down the bridge commitment to close the transaction.

## Advantages of Bridge Financing Commitments

Sellers to investment grade companies typically expect that the obligation of the buyer to close the acquisition will not have a financing contingency. In addition, the seller will want to know the general sources of the cash portion of the purchase price. The bridge commitment fills the gap on the financing, without requiring the borrower to have the cash on hand at time of the signing of the acquisition agreement.

Additionally, while an investment grade company is generally able to access the capital markets on short notice on favourable pricing terms, in an acquisition there is often an extended period between signing and closing while regulatory and shareholder approvals are obtained. Raising the permanent financing immediately upon signing might lock the borrower into funding it may not eventually need, require an expensive escrow arrangement for notes with expensive call premiums, and/or require the borrower to incur bank term loans. In each such case, the closing of the financing would require the immediate payment of financing fees and the ongoing added interest expense during the executory period with no guarantee that the acquisition will close. Consequently, a bridge commitment allows the borrower to defer incurring the expense of raising permanent financing until it has better visibility on the likelihood of closing.

Once the conditions to closing are satisfied, the borrower will be obligated to close promptly. If at that time, the market for permanent financing is unavailable to the borrower, the borrower might not be able to raise the financing required on favourable terms, or at all. As a result, it reduces risk on both the borrower and the seller to obtain a bridge financing commitment. It also makes a potential buyer’s bid more competitive, since a competing bid would arguably also need a bridge commitment to be credible and the competitor might find that banks are unwilling or not able to issue large commitments to multiple bidders.

## Documentation

The initial documentation for a bridge facility commitment will include a commitment letter, together with a term sheet setting forth the terms and conditions of the bridge loan. There will also be a fee letter documenting the fee arrangements with the lead arrangers. In addition, there will be an engagement letter for the notes component of the permanent financing to be issued in the capital markets (as opposed to term loans). The financing letters will be signed concurrently with the acquisition agreement.

The process of negotiating the bridge facility commitment may require substantial time, depending on how many lead arrangers compete for the assignment or the level of detail specified in the term sheet. The borrower may seek proposals from multiple banks and conduct parallel negotiations with each in an effort to identify competitive terms. Alternately, the borrower may elect to work initially with only one or two institutions in order to avoid bringing additional parties that could complicate the confidential acquisition process.

The commitment letter and fee letter do not include many of the detailed provisions which are set forth in the credit agreement. However, the letters are meant to cover all key economic terms and are thus highly negotiated.

If the borrower has an existing credit facility prior to announcement of the acquisition, the credit agreement for such facility will often be agreed by the parties as the documentation precedent for the bridge loan. Among other things, any financial maintenance covenants in the bridge facility will typically track the financial covenants in the borrower's existing credit facility. However, as is discussed below, the closing conditions in the bridge credit agreement will be more limited than in the borrower's existing bank credit facilities. In particular, the occurrence of most events of default (except as to bankruptcy or specified representations and warranties) are typically not a closing condition.

## Conditions

The conditions precedent to funding the bridge facility are a key component of the commitment letter. In general, the conditions to funding the bridge loan are very limited, especially as compared to a bank commitment letter in certain other acquisition scenarios. Acquisition bridge commitments adhere to the principal of "limited conditionality", which provides for a narrow set of conditions, the satisfaction of which is largely in the borrower's control.<sup>2</sup>

For the lenders, the basic conditionality requirements are twofold. Mainly, if the seller fails to satisfy the conditions to closing in the acquisition agreement, the lenders are not required to fund. Second, the borrower must comply with basic documentary formalities, and provide its historical financial statements, and depending on the significance of the transaction, those of the target, in order to facilitate placing the permanent financing. Specific components of these conditions are further summarised as follows.

### Information-related conditions

Depending on the significance of the acquisition, financial statements of the acquired company and *pro forma* financial statements might be required by the SEC to market the permanent financing in a public offering. Consequently, the borrower may need to require delivery of additional financial information from the seller beyond what the target company has historically prepared in order to satisfy the bridge financing conditions. This is most likely to become an issue for negotiation if the target company does not already have audited financial statements, which could occur if the target company is a division of another company. It is also customary for the acquisition agreement to contain a covenant in which the target company agrees to cooperate with the borrower's financing process.

However, it is not customary in an investment grade bridge commitment to have, as a condition to funding the bridge, a specific minimum "marketing period" for the marketing of a notes offering, during which the requisite financial information was available. Such marketing periods are typically seen in below investment grade bridge loan commitments.

### Acquisition-related conditions

Certain conditions to the bridge financing have the effect of ensuring that the acquisition proceeds in a manner not materially different from what was agreed by the borrower and the seller at the time of the bridge commitment.

Prior to making the bridge facility commitment, the lead arrangers will have been afforded the opportunity to review the acquisition agreement, as well as conduct due diligence on the seller and the target company. As a result, the scope of the representations and covenants in the acquisition agreement will have been satisfactory to the lead arrangers at the time of signing. The bridge facility will then include certain conditions directly tied to the acquisition agreement.

First, there will customarily be a condition that the acquisition agreement will not have been amended, modified or waived after the signing date in a manner that would be materially adverse to the lenders. Second, lenders will require that there be a condition that no "Target Material Adverse Effect" (as such term is defined in the acquisition agreement) shall have occurred during the period between the signing of the commitment and closing. Third, the lenders' requirement to fund the bridge loans will be conditioned upon the representations and warranties in the acquisition agreement with respect to the target company that are material to the interests of the lenders being true and correct in all material respects at closing, to the extent that, as a result of such breach of representations and warranties, the borrower has the right to terminate the acquisition agreement.

In each case, the acquisition-related conditions in the bridge commitment letter should track the corresponding conditions in the acquisition agreement. The conformity of the conditions is important to the buyer (and seller) so that, once the conditions to the acquisition are satisfied and the parties are in a position to close the acquisition, there is certainty of funds and they know that the conditions to the bridge loan financing will also be satisfied.

### Other conditions

In addition to the description above, the conditions to funding the bridge will include (i) the accuracy in all material respects of certain fundamental or "specified" representations as to the borrower under the bridge loan credit agreement, (ii) the delivery of customary certificates and legal opinions, (iii) the delivery of "know your customer" information required by law with respect to the borrower, (iv) payment of fees and expenses, and (v) absence of bankruptcy defaults as to the borrower.

## Syndication

The initial bridge commitment is often provided by only one or two lenders acting as lead arrangers, who then seek to syndicate a substantial portion of their commitments to a group of financial institutions. The syndication process is planned in advance by the lead arrangers and the borrower with pre-identified potential syndicate lenders, who are often (but not required to be) the borrower's existing relationship banks.

As part of the syndication process, the lead arrangers and the borrower will host a conference call or bank meeting to provide information (on a confidential basis) to the potential syndicate lenders regarding the acquisition and the terms and conditions of the bridge financing. The syndicate lenders will then commit to their

respective allocations of the bridge facility, either through a joinder agreement to the commitment letter or by entering into a bridge loan credit agreement with the borrower and the lead arrangers. Upon entering into such joinder agreement or credit agreement, the syndicate lenders will generally be contractually committed to fund the bridge in their respective syndication amounts, and the lead arrangers will thereafter only retain a contractual commitment to fund in respect of the non-syndicated amount.

Concurrent with their commitments under the bridge facility, the syndicate lenders will be engaged for a proportionate role in the permanent debt or equity financing to fund the acquisition. For the syndicate lenders (like the lead arrangers), they are willing to commit capital to back the bridge commitment, so that in addition to sharing in the bridge fees, they are afforded the opportunity to earn fees associated with the future debt or equity offerings of the borrower *in lieu* of or to refinance borrowings under the bridge facility.

If the lead arrangers are unable to complete the intended syndication with the pre-identified group of lenders, they may expand the syndicate to additional institutions subject to certain limitations. Any additional institutions will at least be subject to consultation with the borrower (and will typically require the borrower's reasonable consent), and the commitment letter may specify that all syndicate lenders be institutions with investment grade credit ratings.

If the intended syndication is not achievable because banks are unwilling to take on a portion of the commitments on the agreed terms, the lead arrangers may exercise their "flex" rights to make the terms of the bridge facility more favourable to the lenders. The "flex" for an investment grade bridge facility will typically be limited to an ability to increase pricing by up to a certain negotiated amount, but can include other changes to the terms of the bridge facility.

Prior to funding of the bridge, any assignment by the syndicate lenders of their commitments will be subject to consultation with the borrower, or its consent. In many financings, borrower consent is not required for assignments to existing syndicate lenders or their affiliates. In addition, the borrower may be able to designate "disqualified" institutions, consisting of competitors of the borrower and other institutions identified by the borrower prior to the initial commitment date, which may not become lenders without the borrower's consent in its sole discretion, either before or after funding of the bridge.

In order to avoid interference with the syndication, the commitment letter will typically include a "clear market" provision. The clear market prohibits competing financings, with exceptions for the anticipated permanent financings, refinancings of existing debt and other ordinary course financings. Other exceptions to the clear market provision are often requested by borrowers to address specific situations or needs of the borrower and are often highly negotiated. Another consideration in negotiating the "clear market" is whether it will apply only to the buyer or to the target business as well (and whether the seller will agree in the acquisition agreement to comply). To facilitate syndication, the commitment letter will contain a covenant in which the borrower agrees to cooperate with the arrangers, and to use commercially reasonable efforts to cause the seller to also cooperate. However, compliance by the borrower with the cooperation covenant would usually not be included as a condition to the lenders' obligation to fund the bridge loans.

### Commitment Reductions and Permanent Financing

During the period between signing and closing of the acquisition, the banks will require that the proceeds of any significant capital raise not required for a specified purpose be applied to pay the

acquisition consideration. As such, lenders will ask to include in the commitment letter that the bridge facility commitment be reduced on a dollar-for-dollar basis with the net proceeds of debt and equity issuances and non-ordinary course asset sales, subject to certain negotiated exceptions.

The permanent financing to reduce the bridge facility may comprise the proceeds of debt, in the form of bonds or term loans, and/or the proceeds of an equity offering. The composition of the permanent financing will be based on factors including market conditions, desire to maintain a certain credit rating and other capital structure considerations.

Exceptions to the commitment reduction requirement are intended to anticipate other capital needs of the borrower during the period between signing and closing of the acquisition. For example, if there is a need to raise funds to refinance existing debt during the commitment period but prior to closing, or to make a separate investment or acquisition that may take place during such period, then such amounts should be excluded from the mandatory commitment reduction requirement. One point that is often negotiated is whether this exception to raise money to refinance existing debt should apply only to debt maturing during the commitment period or also to debt maturing within a limited time period after the commitment period terminates (i.e. through one year after the termination date of the commitments). In addition, amounts borrowed under existing credit lines will typically not be required to reduce the bridge. Furthermore, it is customary to set a "*de minimis*" threshold, below which proceeds of debt and asset sales will not be required to reduce the bridge facility commitment. A "*de minimis*" threshold for equity proceeds is less common.

### Fees and Pricing

The economics for lenders in a bridge facility commitment include several types of payments which are scheduled to be made at different times during the period of the commitment.

First, the lead arrangers and any other lender that provides a commitment may be paid a commitment fee for their initial commitments at signing of the acquisition agreement. The amount of this fee is not publicly disclosed.

Second, the lenders will be compensated for maintaining the commitment for an extended period of time by a "ticking fee", the terms of which are generally set forth in the term sheet. There is often a second commitment fee paid on the outstanding amount of the bridge commitments as of a specified date after signing, also related to the commitment being maintained for an extended period. These fees will be paid on a *pro rata* basis to all lenders in the syndicate at such time. The dates on which the ticking fee commences and any additional commitment fee is paid are points for negotiation, and may vary across deals based on transaction-specific circumstances and market conditions.

Third, the lenders will be compensated for funding the bridge commitment paid as a one-time funding fee payable on a *pro rata* basis to the bridge lenders. In addition, the lenders might be entitled to a "duration fee" at 90, 180 and 270 days after funding. The most typical structure of the duration fee is 0.50% after 90 days, 0.75% after 180 days and 1.00% after 270 days. The purpose of the "duration fee" is to encourage the borrower to refinance a funded bridge loan with permanent financing as expeditiously as possible after the closing date.

Fourth, the initial interest rate margins on the bridge facility will increase following funding of the bridge. The most typical rate of increase for interest rate margins is 0.25% on each of the 90<sup>th</sup>, 180<sup>th</sup> and 270<sup>th</sup> days after funding.

To address potential changes in the business prospects of the borrower between signing and closing (and after funding), the interest rate margins for the bridge loan will typically be based on a ratings-based grid. Pricing will therefore adjust higher or lower in order to reflect the credit ratings of the borrower at any given time. The ticking fee rate may also be ratings-based, though a flat ticking fee is not unusual.

In addition to the fees set forth above, all of which are directly connected to the bridge commitment and the bridge facility, the lead arrangers and the other lenders will also earn customary negotiated fees in connection with debt and equity offerings for the permanent financing.

The commitment letter, fee letter and/or engagement letter, as the case may be, will usually provide that the committing lenders are entitled to some or all of the fees payable in connection with the bridge commitment or the permanent financing, if the borrower pursues an alternate transaction in which other lenders are engaged to provide financing for the acquisition. The specific terms of what type of transaction and/or alternate financing would require payment of the alternate transaction fee, as well as which fees and what percentage of those fees would be payable, are highly negotiated and may differ from deal to deal.

### Market Trends

*Documentation.* The documentation for investment grade bridge facilities has tended to become less burdensome. Traditional market practice had been for the borrower to enter into a credit agreement with the lenders upon completion of syndication, with the credit agreement superseding the commitment letter provided at signing. Increasingly, syndication of the bridge commitments is documented through the commitment letter, rather than a credit agreement. In such cases, the parties will negotiate a bridge loan credit agreement only in the event that funding of the bridge facility appears likely to occur. By foregoing a credit agreement at the outset, the borrower is able to avoid a costly and potentially time-consuming negotiation process for an agreement that the parties do not expect to be needed for funding.

*Committed financing.* Interest rate margins and duration fees for bridge facility commitments have remained stable and competitive through year end 2017, aligning with continued strength in the bank debt market and capital markets generally during that period. Yet, those strong market conditions have generally not caused borrowers to forego bridge commitments to fund acquisitions, even though bridge facilities come at significant expense and companies have been able to access the capital markets without difficulty. There are exceptions, including for high investment grade companies and acquirors with sufficient capacity under an existing debt facility, or

sufficient cash on hand, to fund the acquisition consideration. Under such circumstances, parties are more likely to conclude that a bridge facility backstop is not needed. Otherwise, however, acquirors and sellers continue to value a bridge facility as a backstop against market disruption or the acquiror suffering a material adverse change during the term of the acquisition agreement and to ensure available funds to close the transaction. It remains to be seen if a rising interest rate environment would affect the investment grade bridge loan market.

*Non-bank lenders.* We have not seen a trend of non-bank lenders taking lead arranger roles in the investment grade bridge market. This is in contrast to the below investment grade market where non-bank credit fund managers are moving up the league tables with larger market shares.

### Conclusion

Bridge financing commitments in very large sums are available to investment grade companies. The closing conditions generally are limited, and within the control of the borrower or mirror those in the acquisition agreement so that the borrower does not find itself in a situation in which it is required to close the acquisition but does not have the funds to pay the purchase price. While the overall process is highly negotiated, certain conditions to funding, interest rate margins and duration fees have started to become more standardised across the market.

### Endnotes

1. Investment grade companies are those that have “investment grade” credit ratings from the major rating agencies. This means, in the case of Standard & Poor’s, a rating of BBB- or better, and in the case of Moody’s, a rating of Baa3 or better.
2. The commitment letter typically will limit the borrower’s damages if the lender fails to fund to direct damages. For a related recent case, see *Weisfelner v. Blavatnik (In re Lyondell Chemical Co.)*, No 17 cv4375 (DLC), 2018 BL 24643, (S.D.N.Y. Jan. 24, 2018) (upholding damages limitation in credit agreement when lender refused to fund a draw under a revolving credit agreement).

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